Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996	)	CC Docket No. 96-128
	)	
Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation	)	CC Docket No. 91-35

REPLY COMMENTS

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Dated: September 9, 1997

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REPLY COMMENTS

MCI Telecommunications Corporation (MCI) hereby replies to the comments filed in response to the Commission's Public Notice concerning the issues remanded by the Court in the payphone proceeding.

I. COMPENSATION MUST BE COST-BASED

As demonstrated by MCI and others in their comments,[1] compensation for subscriber 800 and access code calls must be based on payphone providers'(PSPs') actual efficient cost of providing access for such calls. Not only does this approach follow the Commission's own prior rulings for setting compensation, it ensures 'fair" compensation for payphone providers; it is in the

[1] AT&T Comments at 2; Sprint Comments at 5; CompTel Comments at 10.

public interest; and it is in compliance with the Courts' remand.

In its Order, the Court found that there was no rational basis for the Commission's conclusion that payphone compensation for originating subscriber 800 and access code calls should be set at the market price for local coin calls. Specifically, the Court found that the record showed there are substantial differences in the costs of coin and non-coin calls, such as subscriber 800 and access code calls, which the Commission failed to consider. Thus, the Court ordered the Commission to reexamine this issue.

The comments filed in response to the Public Notice demonstrate that the cost differences between coin and non-coin calls are significant and that the retail price for local coin calls is not an appropriate surrogate for the costs of originating a non-coin call. The cost study filed by MCI in the record of this proceeding shows that the cost to PSPs of providing access for non-coin calls is less than 8.3 cents per call. AT&T's revised cost study demonstrates that the actual average cost of providing payphone access for non-coin calls is, at most, 11 cents per call.[2]

Even if the Commission determines the cost of non-coin calls by subtracting coin costs from the cost of coin calls, AT&T's comments demonstrate that the appropriate offset should be at least 50%. Therefore, based on the cost of coin calls for NYNEX in Massachusetts--which, by its own admission is approximately 17 cents per call-- compensation for non-coin calls should be approximately 8.5 cents.

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[2] AT&T Comments at 11-12.

II. COMPENSATION SHOULD NOT BE BASED ON A MARKET RATE

The comments demonstrate that compensation for non-coin calls should not be based on a "market" rate or determined by subtracting coin costs from the market-based rate for coin calls. As an initial matter, the Court has rejected the Commission's conclusion that the market-based rate for local coin calls is a surrogate for the cost of access code and subscriber 800 number calls. In addition, it is now clear that the Commission's premise concerning the "market" for access code and subscriber 800 number calls-- that carriers can prevent excessive market-based charges for these calls and negotiate lower compensation rates by blocking such calls where the compensation rate is unacceptable-- is incorrect. Carriers cannot negotiate different rates with thousands of PSPs, in part, because of the sheer size of such an effort. Furthermore, even if carriers could negotiate a lower compensation rate with PSPs, it would have no effect because they cannot selectively block subscriber 800 calls-- in other words, carriers cannot currently block subscriber 800 calls from some payphones and not others. [3]

In addition, wide-scale blocking of subscriber 800 numbers from payphones is not in the public interest. Although blocking will prevent carriers and 800 subscribers from incurring excessive payphone compensation rates, it clearly is not in the interest of consumers or in compliance with the intent of Congress to encourage the "deployment of payphones in the public interest." Congress could not have intended to spur the placement of payphones that cannot be used to access certain types of calls-- such as 800 calls. In addition, it is not in the public interest for carriers and ratepayers to spend billions of dollars to build a ubiquitous telephone network and then for the Commission, in the name of payphone compensation and administrative convenience,

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[3] MCI Comments at 4; Pagemart Wireless, Inc. Comments at 4.

to nonchalantly eliminate ubiquitous access. Rather, the Commission must establish a cost-based compensation rate that does not lead to this result.

In any event, contrary to the assertions of the RBOC/GTE/SNET Payphone Coalition (RBOC Coalition) and APCC, it is clear that a 35 cent compensation amount is not an acceptable market-based rate, based on the demands by subscriber 800 customers that carriers block calls from payphones with compensation at that amount.

There is no merit to the RBOC Coalitions' contention that a compensation amount of less than 35 cents per call would lead to the removal of 20% of payphones.[4] This argument defies logic because the affected payphones were placed and maintained when the LECs did not get <u>any</u> Commission prescribed compensation. It is hard to understand how the receipt of compensation-- no matter how little-- where before there was none, could lead to the removal of payphones. Even considering the fact that LECs are required to remove payphone costs from their interstate and intrastate ratebase, it cannot credibly be argued that a 35 cent compensation rate is necessary to maintain the current number of payphones. On the contrary, the level of rate reductions to date would translate into a per-call amount of approximately 13.7 cents per subscriber 800 and access code call. And, if BOCs 0+ calls from payphones are included, the per-call amount would be even less.

In any event, the Act and the Commission's orders provide for the establishment of "public interest payphones." Therefore, to the extent there are any payphones necessary to the public interest that would not be viable if compensation is based on cost, the PSP should avail [redacted]

The Commission also must reject the arguments of APCC to establish a market-based rate for subscriber 800 and access code calls based on other surrogates such as commission payments for 0+ calls, the rate for LEC 0- transfer services, and the sent paid toll call pay station charge.[5] The Commission has already rejected the use of these surrogates and there is no reason to revisit that decision now. In any event, 0+ commissions and LEC 0- transfer service rates clearly are not surrogates for the costs incurred by PSPs in providing access for subscriber 800 and access code calls from payphones because these rates are specific to the type of call and apply to calls from phones other than payphones. Rather, the 0+ commission represents the value to the carrier of being the presubscribed carrier and in receiving calls from customers in addition to the carriers' presubscribed customers. And, the LEC transfer service rate purportedly represents the cost to the LEC of transferring a call to another carrier and the value to that carrier of receiving "0" dialed calls from a phone. Also, the sent-paid toll call surcharge-- a surcharge imposed when the customer places a toll call from a payphone using coins-- clearly cannot be a surrogate for the cost of providing access to non-coin calls any more than the cost of local coin calls is an appropriate surrogate.

III. EXCESSIVE COMPENSATION RATES WILL DECREASE CONSUMER WELFARE AND ARE ANTICOMPETITIVE.

The Commission's determination of the compensation for access code and 800 calls will have profound effects on consumer welfare, potentially reducing consumer welfare by hundreds of millions of dollars in search of an elusive goal of stimulating payphone supply at marginal

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[5] APCC Comments at 7.

locations. The decision to locate a payphone at a specific location is a qualitative choice - the phone is either placed or it is not. Placement occurs when the present value of the expected revenue stream from payphone services is sufficient to cover the present value of all future costs. Thus, for every existing payphone this condition is, by definition, satisfied (i.e., the expected revenue exceeds the expected costs).[6] If the price of access code calls is increased, assuming that the demand for such calls is inelastic, then the revenue generated by these calls will increase despite the reduction in the number of such calls.[7] To the extent that revenues at marginal locations are increased, payphone providers will now find locations that were previously marginal to be profitable and will locate phones at these locations (up to the point where revenue equals cost).[8] The placement of these new phones, since they provide services of value, will add to consumer

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[6] In theory, the revenue from the "last" phone, or the marginal phone, just equals its cost.

[7] Since the demand for access code calls is a derived demand, the own-price demand elasticity of those services is expected to be small and most likely inelastic. This assumption presumes that the price per-call is not raised sufficiently high so as to enter the elastic region of demand. The high per call price proposed by some parties might very well lie in the elastic region of demand and the demand elasticity for long distance calls from payphones is likely becoming increasingly elastic over time as the penetration rate of cellular phones continues to grow. The assumption of inelastic demand is not necessarily appropriate for 800 calls, since it is not the originator of the call who must pay the charge. The 800 service providers are more likely to simply block calls from payphones.

[8] Professor Hausman claims that a rate below $42 per call would reduce the number of payphones. This claim is absurd because the LEC payphones will enjoy more revenue per payphone than in the past, and the higher revenues per payphone will encourage them to place more payphones. Although LECs will lose revenue from CCL charges, payphone set charges, and intrastate subsidies, they will gain even more revenue from dial-around compensation, increased local coin rates after deregulation, and commissions from long-distance providers. Hence, the LEC payphones are not at risk due to the pricing structure. Furthermore, Professor Hausman assumes that payphone providers are presently being compensated more than $0.42 per call since a reduction in revenue is required to reduce the number of phones.

welfare; however, like any price increase, raising the price of access code calls will *diminish* consumer welfare at the existing, inframarginal locations (nearly 2 million phones). In other words, the consumer benefits from an increased number of payphones come at the expense of an enormous wealth transfer from consumers to payphone operators and location owners at existing locations.[9] This is a point often ignored. The primary winners and losers in this matter are premise owners and ratepayers. Higher compensation rates primarily translate into a flow of revenue out of consumers' pockets – with very limited offsetting benefit – to premises owners enabled to expropriate an increased monopoly rent from payphone operators.

An actual estimate of the consumer welfare effects of high prices for access code and 800 calls is very difficult to obtain, though general observation suggests that above cost charges for access and 800 calls are an expensive way by which to increase the number of payphones.[10] First, the number of new profitable locations that result from a "high" price for coinless calls is likely to be small, since a payphone at a marginal location will be less intensely used than an existing phone - even at current prices. Thus, it is highly likely that only a small number of marginal locations will become profitable after the price increase, so that only a small number of payphones are added. This limited response in the number of payphones means that high compensation rates will have negative consumer welfare consequences. Second, the demand for payphone services, and thus potential consumer welfare, at marginal locations will by necessity be lower than that for existing

[9] If the price of access code and 800 calls is set above marginal costs, the reduction in consumer welfare on existing payphones will always exceed the benefits to payphone operators, i.e., there will be a dead weight loss in addition to a transfer.

[10] In an attempt to better quantify the consumer welfare effects, MCI has initiated a study on the effects of payphone compensation and the quantity of payphones.

phones. Thus, even if the supply response were non-trivial, the additional payphones are not worth as much to consumers as existing payphones.[11] What this means is that if the number of access code calls at an airport payphone is greater than the monthly volume of calls on a "marginally" profitable payphone, the cost of the higher compensation rate to callers at the airport will likely exceed in one day the entire monthly consumer welfare generated at the marginal phone. In sum, there is reason to believe that the primary consequence of a high price for access code calls is a substantial transfer of income from consumers to payphone providers and premises owners.[12]

Some parties contend that the local coin rate resulting from the "deregulation" of payphone providers (in a few state) constitutes a "market determined" or "competitively determined" rate. This fallacy is a consquence of the failure to understand what purpose competition serves in the payphone business.[13] Economists have long recognized that there are two notions of competition:

> ... intellectual history holds two distinct notions of [competition]... The most common, non-technical use of the term "competition" describes a contest between two or more parties to achieve the same prize, e.g.,

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[11] The tradeoff is between the sum of the transfer (or Tullock costs) and dead weight loss (or Harberger costs) on inframarginal phones and consumer surplus (the area below the demand curve and above price) for the marginal phones.

[12] If price exceeds costs, a dead weight loss will result in addition to the transfer.

[13] Additionally, there is no reason to expect that "competitively determined" rates for local coin calls would be identical at all payphone locations given that the cost and commissions can vary substantially by location. If markets do in fact drive prices to cost, then the price for coin calls should vary according to cost differences across locations. The uniform price for local coin calls in "deregulated" states, absent information on why payphone operators find it more efficient to charge a single price, is a further indication that one must look to something other than competition as the determinate of the local coin rate.

economic profits.... Another kind of [competition] is described by the contest to obtain an exclusive right to serve.... It usually takes the form of competitive bidding to secure a franchise, the monopoly status of which is subsequently sustained by force of law.[14]

It is this latter form of competition that characterizes the payphone industry, where location owners grant the right to place a payphone to the payphone operator offering the highest "bid."[15] In effect, the winning bid is offered by the payphone operator who best determines the *monopoly price*, not the competitive price, for payphone services. Thus, the local coin rate is more likely to reflect the monopoly determined rate for local calls than the "competitively determined" rate. It hardly seems consistent with the goals of Congress or the Commission to promote policies that, at the expense of consumers, maximize transitional rents for payphone operators or the extractable rents of location owners. Rather than the typical benefits that competition brings consumers (e.g., lower prices, high quality), the type of "competition" that has emerged in the payphone business ensures that millions of dollars of consumer welfare are transferred to premises owners via payphone operators.

Finally, high coinless rates are "anticompetitive" in that they reduce competition in the provision of long distance services from payphones by "raising rivals' costs."[16] By raising the cost of access code and 800 calls, the payphone operators are able to increase the prices of their rival long distance providers without lowering their own costs or prices.[17] Efforts to reduce competition for

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[14] Robert B. Ekelund and Robert F. Hébert, The Proto-History of Franchise Bidding, Southern Economic Journal, Vol. 48, October 1981, pp. 464-74, at 464.

[15] The theory of franchise bidding implies that the holder of the property right, typically the state, offers the right to be the sole provider to the bidder who offers to provide a pre-determined quality of service at the lowest price. Location owners, however, are not bound by law to accept the lowest bid for a given level of quality but instead will seek out the bid that maximizes their own wealth.

[16] Steven C. Salop and David T. Scheffman, "Raising Rivals' Costs," American Economic Review, Vol. 73 (May 1983): 267-71.

[17] As recognized by the Commission, the growth of the dial around and 800 access industry is very much a consequence of some OSPs charging above competitive prices for

long distance calls from payphones has led, in numerous cases, payphone operators to illegally block or re-route consumers away from the consumer's carrier of choice to their operators own, higher priced services – a blatantly anticompetitive action. A "raising rivals' cost" strategy, especially if implemented and enforced by regulators, will be far more effective than these illegal activities. Surely the Commission recognizes that calling cards (both debit and credit) and 800 operator services (e.g., 1-800-COLLECT) are an important, if not the only, source of competition in the payphone originated long distance market and that these substantial consumer benefits provided by these alternatives are at risk by excessive per call compensation for access code and 800 calls.[18]

IV. DEFAULT COMPENSATION SHOULD NOT VARY

The comments demonstrate that the Commission prescribed default compensation for subscriber 800 and access code calls should not vary when the rate for local coin calls varies beginning in October, 1998. As demonstrated by AT&T, it would be extremely costly, difficult and time-consuming for carriers to be able to implement varying compensation amounts and blocking options for millions of payphones, with the necessary systems development work reaching "hundreds of millions of dollars."[19] In addition, according to AT&T, the cost to administer compensation payments will more than double to administer a uniform per-call rate and could increase an additional 300% to administer a floating rate.[20]

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interexchange and operator services (NPRM, ¶ 9)

[18] Unlike local coin calls, consumers in need of a payphone for long distance calls have the option to choose among the competing services of a multitude of carriers.

[19] AT&T Comments at 17.

[20] AT&T Comments at 18.

In addition, a varying compensation amount currently is not feasible, and cannot be feasible unless the Commission sets some parameters. At a minimum, PSPs must be required to provide to carriers the coin rate for each phone well in advance before any compensation is owed; PSPs should only be allowed to change the per call amount once a year; and PSPs should only be allowed to set one default compensation amount for each phone. PSPs, for example, should not be able to set a default compensation amount based on time of day. Even with parameters, however, a floating rate would be susceptible to fraud and abuse because carriers would have no way of verifying the effective compensation rate for a payphone and would have to rely on the PSP for such information.[21] On balance, therefore, a variable default compensation amount should not be implemented.

V. INTERIM COMPENSATION PLAN

The Commission was never required to institute an interim compensation plan[22] and, given the many deficiencies found by the Court with its current plan and the fact that the interim period is almost over, the Commission could simply eliminate interim compensation. If, however, the Commission proceeds with revising the interim compensation plan, interim compensation must be cost-based.

Since data on toll revenues is available, and in the absence of other data, the Commission should determine the carriers' relative compensation obligations based on total toll revenues

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[21] AT&T Comments at 16.
[22] Sprint Comments at 12.

(interstate and intrastate). Carriers with toll revenues of less than $100 million could be assessed an equal amount of compensation based on their combined percentage of toll revenues.

Interim compensation should be set at an amount equal to the estimated number of calls from payphones (131 per month) times the new per-call compensation amount which, as indicated above, is no more than 11 cents per call. As noted by AT&T, the Commission determined that 131 represented the average number of access code and 800 subscriber number calls per payphone during the interim period based on the data submitted on the record from five PSP sources, including the RBOCs and APCC, and that this figure was not raised on appeal by any party or modified by the Court.[23] Accordingly, the Commission must reject the attempts of APCC and People's Telephone to now argue that the number of compensable calls during the interim period should be increased (the RBOCs provide no new data). In any event, the "new" call volumes presented by these parties are suspect. As an initial matter, PSPs cannot determine when a call is completed and, therefore, the call volumes shown by APCC (an average of 152 calls per phone-- up from its previously filed data of 142 calls) and People's Telephone (an average of 139 calls) most likely include uncompleted, non-compensable calls. It appears that People's call volumes are further inflated because data is provided only for the period of February through July, 1997. It is worth noting that the heaviest call volume is in May, June and July--which coincides with spring break and the summer months when people vacation and travel. In light of the discrepancies and unreliability of the data presented in the comments, the Commission should continue to use 131 as the estimated number of access code and subscriber 800 calls for purposes of interim compensation.

[23] AT&T Comments at 19.

Sprint suggests that the Commission should calculate interim compensation based on the actual number of calls carriers receive once per-call compensation becomes effective. According to Sprint, each carrier that is obligated to pay per-call compensation should calculate the total number of compensable dial-around and subscriber 800 calls it handles for the calendar month of November 1997 and divide that number by the total number of payphone lines as reported on the most recent LEC lists to determine the carrier's average number of compensable calls per payphone line.[24] MCI would not oppose an interim compensation plan based on this proposal with one change-- namely, compensation should be based on the number of payphone lines reported for each quarter of the interim period and not as reported on the most recent LEC list.

Finally, LECs that carry toll traffic must also pay interim compensation. As demonstrated in the comments, many LECs provide interstate and intrastate access code and subscriber 800 services.[25] Moreover, the 131 estimated average number of calls from payphones includes both interstate and intrastate calls. Accordingly, all interstate and intrastate toll carriers-- including the LECs-- must be required to pay their fair share of interim compensation.

VI. 0+ COMPENSATION

As demonstrated by MCI, the Commission was not required to prescribe compensation for 0+ calls, and it did not do so for non-BOC PSPs in its Payphone Orders because PSPs other than the

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[24] Sprint Comments at 13.

[25] AT&T Comments at 21.

BOCs had the ability to enter into contracts with the presubscribed operator service provider (OSP) -- or other party such as the premises owner -- to receive whatever compensation they felt was "fair." To the extent any non-BOC PSP did not enter into a contract directly with the presubscribed OSP, it was by their own choice. Therefore, it must be assumed that whatever "deal" to which they agreed-- regardless of whether the agreement is with the presubscribed OSP-- provides "fair" compensation. Otherwise the PSP would not have agreed to place a payphone at the location.

Importantly, the Act does not require that compensation be paid by the presubscribed OSP. It only requires that the Commission prescribe regulations that "establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call using their payphone."[26] For 0+ calls, the Commission has fulfilled its requirement by finding that PSPs can ensure fair compensation for 0+ calls through the contract process. For these reasons, the Commission must reject Sprint's request that it prescribe 0+ compensation for all LECs and APCC's request that 0+ compensation should be prescribed for all PSPs that do not have a contract with the presubscribed OSP.

Moreover, the Commission does not need to prescribe 0+ interim compensation for the BOCs because they are able to ensure fair compensation through the ability to work with the location provider to select the presubscribed OSP. For example, BellSouth is imposing a charge of $15 per month on location providers that do not select the OSP selected by BellSouth. Clearly, this charge

[26] Section 276(b)(1)

represents BellSouth's mechanism for ensuring that it is "fairly" compensated for 0+ calls. The Commission does not need to do anything more.

If, however, the Commission prescribes compensation for 0+ calls from BOC payphones during the interim period, compensation should be equal to the cost-based per-call rate as calculated above times an estimated number of 0+ calls from payphones. Compensation based on the actual number of 0+ calls is not always possible since the presubscribed carrier may not always have a contract with the location provider.[27] And, even if there is a contract, compensation based on actual call counts would be extremely difficult to determine because commissions are usually paid based on a percentage of revenue and, therefore, there is no easily obtainable record of the number of calls for any particular payphone. Rather, commission payments would have to be matched against call records to determine the number of calls--which would be difficult, time consuming and, therefore, costly.

VII. COMPENSATION FOR INMATE PAYPHONES

The Commission should not prescribe any compensation for the inmate phones of any PSP, including the BOCs, during the interim period or otherwise, under the same theory as the Commission found it was unnecessary to prescribe compensation for 0+ calls for non-BOC payphones-- namely, all parties involved in providing inmate services have the ability to contract with the location provider (oftentimes the Department of Corrections) for "fair" compensation for the services provided. Thus, all PSPs, including the BOCs, enter into contracts to place payphones at prisons through the location

[27] AT&T Comments at 23.

provider's RFP process and any PSP that does not believe it is being fairly compensated for the placement of payphones at the prison can choose to not provide payphones. The claim of the Inmate Calling Service Providers (ISP) Coalition, therefore, is false-- namely, that ISPs are "wholly uncompensated for the call" because they have no opportunity to negotiate with the carrier for compensation.[28] ISPs are compensated for the services they provide through the contract process and, ISPs clearly have the ability to enter into an agreement with carriers when responding to the RFP. Accordingly, there is no need for the Commission to prescribe additional compensation for inmate payphones.

VIII. OVERPAYMENTS MUST BE REFUNDED TO CARRIERS

Once the carriers' new interim compensation obligations are calculated, carriers that overpaid during the interim period are entitled to be reimbursed for such overpayments back to the effective date of the Commission's interim compensation rule. As demonstrated in the comments, the Commission has the authority to order retroactive refunds of payments that had been required by a prior order that was subsequently overturned on review by the Court of Appeals and thereby "undo" the wrongful effects of its order.[29]

Equity requires that the Commission order such refunds because not only have certain carriers paid excessive amounts of interim compensation, they have, in effect, paid the compensation obligations of their competitors. In addition, no party can claim harm by such adjustments as all were

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[28] ISP Coalition at 3.

[29] AT&T Comments at 24-25, discussing United Gas Improvement Co. v. Callery Properties, Inc., 382 U.S. 223 (1965).

on notice once the appeals were filed that such adjustments might be required.[30] Thus, the Commission must order a true-up of all interim compensation payments to correct the effects of its unlawful order.

The Commission must reject APCC's argument that a retroactive refund should not be ordered based on equity to correct the Commission's error in not ordering compensation for subscriber 800 calls in 1992 when implementing the Telephone Operator Consumer Services Improvement Act (TOCSIA).[31] APCC reasons that the equities favor the PSPs because they were denied compensation for years and IXCs only overpaid compensation for one year. APCC's argument fails for the simple reason that the Commission was not required to prescribe compensation for subscriber 800 calls-- or any calls-- by TOCSIA and, in fact, the Commission only ordered compensation for subscriber 800 calls beginning in November 1996. APCC did not appeal this decision. Therefore, it is precluded from arguing now that compensation for subscriber 800 calls should be retroactive back to 1992. For the same reasons, the Commission must reject APCC's argument that if a retroactive refund is ordered, equity requires the Commission to order additional compensation for PSPs for subscriber 800 calls back to 1992.[32]

Finally, contrary to APCC's assertions, refunding overpayments will not result in a windfall to interexchange carriers (IXCs).[33] As an initial matter, the rate increases referenced by APCC most

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[30] AT&T Comments at footnote 33, discussing Western Resources, Inc. v. FERC, 72 F.3d 147 (D.C. Cir. 1995).

[31] APCC Comments at 21.

[32] APCC Comments at 25.

[33] APCC Comments at 23-24.

likely will not recover the full cost of the system and administrative costs associated with implementing payphone compensation, let alone the actual compensation payments. In any event, even if APCC is correct, it would not justify allowing PSPs to retain unlawful compensation amounts.

IV. CONCLUSION

Based on the foregoing, MCI respectfully requests that the Commission revise its interim and per-call compensation rules as discussed herein and in MCI's comments.

Respectfully submitted,

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Dated: September 9, 1997

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